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No. 88-94

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY AND EQUITABLE GAS COMPANY, A DIVISION OF EQUITABLE RESOURCES, INC.,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF AMERICAN GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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BRIEF OF AMERICAN GAS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The American Gas Association ("A.G.A."), pursuant to Rule 36 of this Court, submits this brief *amicus curiae* in support of the petition for a *writ of certiorari* filed by the Kentucky West Virginia Gas Company ("Kentucky West") and Equitable Gas Company, a division of Equitable Resources, Inc. ("Equitable"), to vacate the judgment of the Court of Appeals for the Third Circuit and remand the case for reconsideration or, in the alternative,

grant plenary review of the court of appeals judgment. A.G.A. has received the consent of all parties to file this brief as *amicus curiae*.

The A.G.A. is a nonprofit trade association representing the interests of approximately 250 member companies involved in the distribution and transmission of natural gas throughout the 50 states and the District of Columbia. A.G.A. member companies account for approximately 85% of this nation's annual gas utility sales. Approximately 32 A.G.A. distribution companies are regulated by more than one state utility commission. Petitioners are members of the A.G.A. and Equitable is regulated by three state commissions and by the Federal Energy Regulatory Commission ("FERC").

INTEREST OF THE AMICUS CURIAE

The question presented in this case regarding the scope of the filed rate doctrine is of particular interest to the members of the A.G.A. that are local distribution companies ("LDCs"). LDCs purchase natural gas from pipelines and other sources at rates and quantities regulated by FERC under the Natural Gas Act of 1938, 15 U.S.C. §§ 717-717z (1982 & Supp. III 1985) ("NGA"), and the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982 & Supp. III 1985) ("NGPA"), and distribute and resell that gas to retail customers at rates regulated by state public utility commissions. This dual federal-state oversight could subject an LDC to inconsistent regulation, with FERC directing the LDC to pay a particular cost at the wholesale level and a state commission barring the LDC from recovering that same cost through its retail rates. The filed rate doctrine is designed to prevent such "trapping" of costs by requiring state commissions to allow LDCs to recover through their retail rates all FERC-mandated wholesale costs. The doctrine thus plays a crucial role in defining the proper relationship between federal and state regulation of the natural gas industry.

In the last few years, first in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and more recently in *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428 (1988), this Court has clarified the contours of the filed rate doctrine as it applies in this context. The decision of the court of appeals, which predated *Mississippi Power*, is clearly inconsistent with the principles spelled out by the Court in that decision. Moreover, the court of appeals' decision is likely to spawn new confusion about the scope of the doctrine by implying that determinations made by state regulators under state law may in some circumstances prevent an LDC from invoking the filed rate doctrine to protect its right to recover FERC-mandated costs. The A.G.A. accordingly submits this *amicus curiae* brief urging the Court to grant the petition, vacate the decision below and remand the case for reconsideration in light of this Court's subsequent decision in *Mississippi Power*. Alternatively, the Court should grant the petition and set the case for oral argument.

ARGUMENT

The Court Of Appeals' Mistaken Interpretation Of The Filed Rate Doctrine Should Be Corrected Because It Is Likely To Create Confusion Among State Regulators And Render Uncertain The Right Of Local Distribution Companies To Recover FERC-Mandated Costs Through Their Retail Rates.

A. *The Filed Rate Doctrine Prevents Conflicts Between State And Federal Regulation Of The Natural Gas Industry And Helps Ensure The Financial Integrity Of Local Distribution Companies.*

The aspect of the filed rate doctrine that is relevant in this case holds that "States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates." *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428, 2439 (1988). If a tariff or contract on file with FERC requires a utility

to pay an unavoidable cost as part of the wholesale rate for a commodity (*see Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-82 (1981)), or requires a utility to purchase a fixed quantity of a commodity (*Mississippi Power; Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986)), the state commission must permit the utility to recover through its retail rates any costs incurred pursuant to that FERC-approved tariff.[1]

This principle, which is grounded in the Supremacy Clause, is a necessary consequence of Congress's decision to endow the Federal Energy Regulatory Commission with exclusive authority to regulate wholesale natural gas rates. *See* 15 U.S.C. § 717c (1982). If the filed rate doctrine did not require state utility commissions to accept FERC's determination that a particular charge imposed upon an LDC as part of a wholesale rate is just and reasonable, and allowed the States to conclude instead that payment of the charge was imprudent or unreasonable, a state commission could bar the LDC from recovering the cost through its retail rates. That would undermine FERC's exclusive authority over wholesale rates and render the comprehensive federal scheme of regulation, under both the NGA and NGPA, for the sale of natural gas in interstate commerce, a nullity. This is the precise purpose for invoking pre-emption.

The filed rate doctrine also furthers principles of fairness, protecting LDCs from the financial injury that would result if they could be caught in the middle of regulatory disputes between FERC and the state commission. Uncertainty about the filed rate will jeopardize the financial decisions of the LDCs as well as the posture

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[1] The filed rate doctrine imposes other limitations with respect to FERC-approved rates. For example, regulated sellers of natural gas may not collect a rate other than the rate on file with FERC, and the Commission and the courts may not retroactively alter the rate charged for gas already sold. *See Arkansas-Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577-79 (1981); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951)

of the LDCs in the financial community. An LDC is assured that it can act on the basis of FERC's findings that a particular cost is reasonable without fear that state regulators might later reach a different conclusion and prevent the utility from recovering the cost from its ratepayers.

B. *The Decision Below Misapplies The Filed Rate Doctrine In A Manner That Is Clearly Inconsistent With The Principles Announced By This Court In* Mississippi Power.

1. The court of appeals failed to consider the significance of the minimum bill provision in this case, even though it recognized that petitioner Equitable had entered into a FERC-approved long-term gas supply contract with petitioner Kentucky West that included a minimum bill provision "requir[ing] Equitable to purchase from Kentucky West a minimum amount of gas in exchange for which Kentucky West guarantee[d] that that amount will be available for Equitable's consumption." Pet. App. at 19a n.7. At the time of the events at issue in this case, minimum bill provisions like the one contained in the Kentucky West contract required LDCs such as Equitable to pay for a specified quantity of gas *whether or not the LDC actually took delivery of the corresponding volume of gas.* The minimum bill provision imposed upon Equitable an unavoidable obligation to pay a fixed sum to Kentucky West.[2]

Contrary to the apparent view of the Pennsylvania Public Utility Commission ("Pennsylvania PUC") and

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[2] Minimum bill provisions were commonplace in the natural gas industry; they guaranteed gas purchasers (such as LDCs) sources of long term supply and guaranteed gas suppliers (such as pipelines) a long term return on their investment. The purpose of such provisions was to allocate risk associated with changes in the levels of supply and demand, protecting purchasers in the event of demand increases or supply shortages and protecting suppliers in the event of demand reductions or oversupply.

the court of appeals, the payments to Kentucky West at issue in this case do constitute payments pursuant to Equitable's obligation under the minimum bill. True, Equitable paid only that part of its minimum bill obligation that corresponded to its actual need for delivered gas and sought to invoke *force majeure* to avoid the balance of its obligation; but it did not ask the Pennsylvania PUC to allow recovery of the unliquidated portion of the minimum bill obligation. Equitable had no unilateral power to cancel its FERC-approved contract with Kentucky West, and to the extent its payments to Kentucky West were below the sum it was federally obligated to pay, they are properly treated as being in partial satisfaction of that federal obligation and therefore subject to the filed rate doctrine.[3]

The filed rate doctrine plainly requires state regulators to permit the recovery in retail rates of payments made pursuant to FERC-approved minimum bills. Indeed, this Court's decision in *Mississippi Power* is dispositive on this point. The Court there held that the filed rate doctrine prevented the State form disallowing costs incurred pursuant to a FERC order allocating a specified amount of high-cost electric power to a utility. The Court stated:

> [I]t might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for [the utility] to procure the particular quantity of high-priced . . . power that FERC has ordered it to pay for.

108 S.Ct. at 2440. As in *Mississippi Power*, Equitable did not have the legal right to refuse to make the purchases of high-priced gas which the Pennsylvania PUC

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[3] This is confirmed by the evident fact that Kentucky West would have had to take Equitable's payments for delivered gas into account in determining its remaining liability under the minimum bill provision.

found imprudent. Therefore, as in *Mississippi Power*, the Pennsylvania PUC lacked the power to bar Equitable from recovering the cost of those FERC-mandated expenditures through its retail rates.[4]

Indeed, putting the filed-rate doctrine to one side for the moment, it is clear that the Pennsylvania PUC should have permitted Equitable to recover its actually incurred minimum bill costs for the entirely separate reason that the purchasing strategy pursued by Equitable was entirely prudent under the circumstances. An LDC facing declining levels of demand while at the same time bound by a minimum bill obligation can best protect its ratepayers by taking the volume of gas specified in the minimum bill provision—for which the LDC must pay in any event—and reducing its purchases from sources of gas not subject to minimum bill provisions, such as independent producers or LDC-owned production. If the LDC took gas from those other sources, as the Pennsylvania

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[4] In both *Mississippi Power* and *Nantahala*, this Court reserved the question whether " 'a particular *quantity* of power procured by a utility from a particular source could be deemed unreasonably excessive if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, *price*.' " *Mississippi Power*, 108 S.Ct. at 2440 (citation omitted; emphasis in original); *Nantahala*, 476 U.S. at 972 (citing *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77 Pa. Commw. 268, 273-74, 465 A.2d 735, 737-38 (1983)). That issue is not presented in this case for the simple reason that it arises only when the costs disallowed by the state commission are optional, not mandatory. *See Mississippi Power*, 108 S.Ct. at 2440; *Nantahala*, 476 U.S. at 972. Thus, the utility in *Pike County* was free to choose whether to procure high-cost power or low-cost power. Here, by contrast, Equitable had *no choice* under its FERC-approved contract but to pay for gas from Kentucky West; the Pennsylvania PUC wrongly presumed that Equitable could choose not to pay Kentucky West and simply purchase gas elsewhere. *See* Pet. App. at 123a, 140a-42a. Because the minimum bill provision obligated Equitable to purchase a specified quantity of gas from Kentucky West, the Pennsylvania PUC's determination that Equitable made an imprudent "choice" violated the filed rate doctrine.

PUC said it should have done, it would have had to pay for that gas *and* make its minimum bill payments as well, a course of action guaranteed to result in higher total gas costs.

2. The court of appeals' erroneous reading of the filed rate doctrine resulted from the "preclusive effect" (Pet. App. at 20a) that the court accorded to the Pennsylvania PUC's "refusal to consider minimum bill liability in evaluating whether Equitable had pursued a least cost fuel procurement policy. . . ." Pet. App. at 21a. But the question before the court of appeals—whether the cost that Equitable sought to recover in its retail rates were protected by the filed rate doctrine because they had been incurred pursuant to a FERC-approved unavoidable obligation—is not a question of fact, but rather a question of law that the court itself should have answered by examining the provisions of Kentucky West's FERC tariff.

The court of appeals' refusal even to consider the relevance of the minimum bill to petitioners' claim under the filed rate doctrine effectively leaves to state regulators the decision whether a particular expense is related to a FERC-approved obligation. One of the basic purposes of the filed rate doctrine is to limit the authority of the States by requiring them to adhere to FERC's reasonableness determinations. If state regulators could preclude a claim under the filed rate doctrine by simply failing to discuss relevant provisions of FERC-approved tariffs in the course of a state-law prudence inquiry, a gaping hole would be opened in the protection afforded by the doctrine, allowing state regulators to override the filed rate doctrine essentially whenever they wish.

The court of appeals' approach is not only wrong as a matter of general principles, it is squarely contrary to this Court's decision in *Mississippi Power*. The Court in that case rejected the argument that findings made in the course of a state-law prudence determination could override the requirements of the filed rate doctrine (*see*

108 S.Ct. at 2440-41). The same result must obtain here: analysis under the filed rate doctrine cannot be short-circuited by factual findings made in a state-law prudence review. The question whether the predicate for application of the filed rate doctrine has been satisfied is a legal issue that must be determined in accordance with federal law.

C. *This Court Should Grant The Petition And Remand The Case For Reconsideration In Order To Avoid Confusion Over The Contours Of The Filed Rate Doctrine.*

Congress's adoption of the NGPA together with subsequent administrative initiatives by the Federal Energy Regulatory Commission, have worked a "comprehensive[] and dramatic[]" change in federal regulation of the natural gas industry. *Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983). By eliminating price controls on most wellhead sales of natural gas, the NGPA "give[s] market forces a more significant role in determining the supply, the demand, and the price of natural gas. . . ." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 422 (1986). The Commission's administrative actions have similarly increased the role of market forces in the wholesale gas market, principally by making it easier for buyers of gas in that market—such as local distribution companies—to shift their business from one supplier to another on the basis of price and other competitive considerations. *See, e.g.*, Order No. 436, 50 Fed. Reg. 42408 (1985), FERC Statutes and Regulations [Regulations Preambles 1982-1985] ¶ 30,665 (1985), *aff'd in part and rev'd in part sub nom. Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 1468 (1988); Order No. 380, 49 Fed. Reg. 22778 (1984), FERC Statutes and Regulations [Regulations Preambles 1982-1985] ¶ 30,571 (1984), *aff'd in part and rev'd in part sub nom. Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986).

This enhanced competition among sellers of gas at the wholesale level has not gone unnoticed by the States. In order to encourage LDCs to take advantage of the new competition in the wholesale market to lower their gas supply costs, an increasing number of States are requiring local distribution companies to pursue a least-cost strategy in purchasing gas supplies. The LDC must show that it purchased gas at the lowest available price in order to recover the cost of gas purchases in their retail rates. Failure to make such a showing may result in the denial of the utility's request for the recovery of gas purchase costs.[5]

As more States subject LDC gas procurement decisions to intensive scrutiny, it is important that the relationship between such state-law inquiries and the filed rate doctrine be clear. The decision below is likely to leave courts uncertain about how to apply the filed rate doctrine in this context. In addition, state regulators might believe that they are free to decide for themselves the extent to which they are required to take account of a FERC tariff in a state-law prudence inquiry. Indeed, the lower court's decision in *Mississippi Power* shows the potential for confusion in this area: despite this Court's then-recent *Nantahala* decision, the lower court in *Mississippi Power*

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[5] Nine States have adopted statutes requiring gas purchasing prudence review. *See, e.g.*, Cal. Pub. Util. Code §§ 785, 785.5 (enacted 1983 and 1985), respectively); Ill. Rev. Stat. ch. 111 2/3, §§ 8-401, 8-402 (effective 1986); Iowa Code Ann. § 476.6(15) (enacted 1984); Md. Code Ann. art. 78 § 54D; Mich. Comp. Laws Ann. § 460.6h; N.Y. Pub. Serv. Law ch. 519, §§ 66-e, 66-f (amended 1984); Ohio Admin. Code §§ 4901:1-14-07, 1-14-08; W.Va. Code §§ 24-2-4c, 24-2-16; Wyo. Stat. § 15-1-103(a)(xxxiii)(C), (b), (c) (effective 1985) and Wyo. Stat. § 37-3-201 through 205 (enacted 1987). Other state regulatory commissions review the prudence of LDC procurement decisions pursuant to their general authority to require just and reasonable rates or to supervise utility energy planning. *See, e.g., Re Nevada Power Co.*, 74 P.U.R. 4th 703 (Nev. P.S.C., May 30, 1986); Wash. Admin. Code § 480-90-191 (promulgated 1987).

completely misconstrued the filed rate doctrine when presented with a case arising in the context of a state-law prudence determination.

Because *Mississippi Power*, which was decided after the court of appeals' decision in the present case, holds that state-law prudence findings are not determinative of the inquiry under the filed rate doctrine, the Court should direct the court of appeals to reconsider its decision in light of *Mississippi Power*. Indeed, failure to direct the court of appeals to reconsider its decision in light of *Mississippi Power* might give state regulators, as well as other courts, the mistaken impression that the decision below is a proper application of the filed rate doctrine. That would cause still more confusion regarding the scope of the doctrine. Since the relief sought by petitioners is limited, and the possibility of damage to the filed rate doctrine is considerable, the Court should grant the petition and remand the case for reconsideration in light of *Mississippi Power*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted, the judgment of the Court of Appeals for the Third Circuit vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co.* v. *Mississippi*, 108 S.Ct. 2428 (1988). In the alternative, the Court should grant plenary review of the judgment of the court of appeals.

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